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Assignment of Mortgages Securing Negotiable Notes

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ASSIGNMENT OF MORTGAGES SECURING NEGOTIABLE NOTES.[1]

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Judge Ranney, speaking for the court in *Bailey v. Smith*,[3] observes that "there is scarcely any business transaction that has been more common and familiar or has oftener engaged the attention of the courts than the assignment of mortgages." Considering the narrowness of the particular point under discussion, this statement is equally true with respect to the problems presented by the assignment of mortgages acompanied by negotiable notes. Due doubtless to the early business custom of giving a non-negotiable bond as evidence of the primary obligation with a mortgage security, the question under consideration was never presented to the courts until 1843, but since that time no less than one hundred and fifty cases have been taken to the courts of last resort in this country calling for an expression of opinion as to the rights of a *bona fide* assignee of a negotiable note secured by mortgage as against the mortgagor. The decisions have developed two conflicting theories. One line of authorities, the majority doctrine, establishes the rule that the assignee takes free from all equities between the original parties. The other line of authorities, the minority doctrine, establishes an exactly opposite rule under which the assignee takes subject to all equities between the original parties. Following is a statement of the rules under discussion.

Where a negotiable note secured by mortgage has been assigned to one taking in good faith and before maturity the prevailing doctrine in the United States is that such an assignee takes the mortgage as he does the note free from all equities existing between the mortgagor and the mortgagee.[4] A contrary rule, however, obtains in a few states in which it is held that a mortgage under all circumstances, whether securing negotiable or non-negotiable instruments, is to be treated as an ordinary *chose in action*, and when assigned the assignee takes subject to all defenses which the mortgagor had against the mortgagee.[5] That is, by the majority rule, a mortgage

1. A paper submitted in partial fulfillment of the requirements for the degree of Doctor of Law at the University of Illinois, June, 1914.
2. Of the Chicago Bar.
3. 14 Ohio St. 398.
4. 1 Jones on Mortgages, Sec. 834; 27 Cyc. 1324.
5. 1 Jones on Mortgages, Sec. 838; 27 Cyc. 1324.

when assigned along with a negotiable note is clothed thereby with the usual incidents of negotiability.[6] The minority rule stands for the proposition that a mortgage can never be treated as a negotiable instrument, that it is essentially a *chose in action* and under the general rule governing the assignment of *choses in action* the assignee must necessarily take the mortgage subject to all equities and defenses existing between the original parties.

Origin and Development of the Doctrines.—The two doctrines obtaining in the United States have undergone a somewhat peculiar development. When the question first arose the rule adopted protected the assignee of the mortgage against equities possessed by the mortgagor against the mortgagee. Then followed an almost uninterrupted series of cases holding that the assignee should not be protected. The question finally being presented to the Supreme Court of the United States,[7] the earlier rule was affirmed as the true one and it has remained to the present time, reaffirmed by a long line of decisions and with scarcely a dissent, and is today the unquestioned weight of authority.

A mortgage debt evidenced primarily by a negotiable promissory note is peculiarly an American business transaction. In England and Canada the primary obligation which is secured by mortgage is usually represented by a non-negotiable bond, consequently, in these countries no cases have arisen involving the rights of a *bona fide* assignee before maturity of a negotiable note secured by mortgage.[8] The two opposing doctrines have therefore been worked out by American courts, unaided by English decisions except in so far as the general principles governing assignment of mortgages, irrespective of the character of the primary obligation, are applicable.

Twenty-three states and the federal courts have passed definitely upon the point, twenty of which and the federal courts follow the majority doctrine, the remaining three represent the minority rule. The majority rule by which a *bona fide* assignee before maturity

6. The phrase sometimes used, that a negotiable note makes a negotiable mortgage, is not strictly an accurate one but serves to indicate in a general way the relative obligations of the parties to the transaction.

7. *Carpenter v. Longan,* 16 Wall. 273.

8. Where the mortgage secures a non-negotiable instrument there is no conflict. All courts are agreed that in such a case the assignee takes subject to equities which could have been raised against the mortgagee. The conflict appears when the mortgage secures a negotiable note. Jones on Mortgages, Sec. 841; Pomoroy Equity Jur., Sec. 733 and note. This rule springs from the doctrine expressed in the oft repeated phrase of Lord Thurlow in the leading case of *Davies v. Austin,* 1 Ves. Jr. 247 (1790), "A purchaser of a *chose in action* must always abide the case of the person from whom he buys, and this I take to be the universal doctrine."

of a negotiable note secured by mortgage is regarded as taking the mortgage as he does the note free from all personal defenses which the mortgagor had against the mortgagee, has been adopted in the following states: Colorado, Indiana, Iowa, Kansas, Kentucky, Massachusetts, Michigan, Missouri, Nebraska, North Carolina, New Hampshire, New York, North Dakota, Oklahoma, South Carolina, Tennessee, Texas and Wisconsin.[9] The United States Supreme

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9. Colorado.—*Longan v. Carpenter,* 1 Colo. 205. Decided by teritorial court. Minority rule adopted but reversed by United States Supreme Court in the leading case of *Carpenter v. Longan,* 16 Wall. 271, which holding has been adopted by the Colorado court in *Cowing v. Cloud,* 16 Colo. App. 326, 65 Pac. 417 (1901), as the law of that state, thus reversing the stand taken in earlier case.

Indiana.—*Gobbert v. Schwartz,* 69 Ind. 450.

Iowa.—*Clasey v. Sigg,* 51 Iowa 371; *Des Moines Savings Bank v. Arthur,* 143 N. W. 566; *Farmers National Bank v. Fletcher,* 44 Iowa 252 (exception: rule not applied when mortgage was on a homestead and wife's signature was obtained by duress); *Nevada v. Bryan,* 62 Iowa 42; *Preston v. Case,* 42 Iowa 549 (mortgage on homestead); *Vandercook v. Baker,* 48 Iowa 199.

Kansas.—*Berry v. Berry,* 57 Kan. 691. (Exception: rule not applied when mortgage was on homestead, and wife's signature was obtained by duress. *Accord, Farmers' National Bank v. Fletcher,* 44 Iowa. 252); *Burnham v. Hutcheson,* 25 Kan. 435; *Converse v. Bartels,* 46 Pac. 940; *Lewis v. Kirk,* 28 Kan. 356.

Kentucky.—*Duncan v. Louisville,* 76 Ky. 578.

Massachusetts.—*Anderson v. Learoyd,* 176 Mass. 43, (unsatisfactory); *Bassett v. Daniels,* 136 Mass. 547; *Taylor v. Page,* 88 Mass. 86; *Watson v. Wyman,* 161 Mass. 96.

Michigan.—*Barnum v. Phenix,* 60 Mich. 338; *Bloomer v. Henderson,* 8 Mich. 395; *Cicotte v. Gagnier,* 2 Mich. 381; *Dutton v. Ives,* 5 Mich. 515; *Helmer v. Krolick,* 36 Mich. 371; *Lockwood v. Nobel,* 113 Mich. 318 (exception: assignee not protected; mortgagor had no title); *Reeves v. Scully,* Walker's Ch. 238 (first case in United States); *Woodcock v. Niles First Natl. Bank,* 113 Mich. 236.

Missouri.—*Bargess Ins. Co. v. Vette,* 142 Mo. 560 (rule applied to trust deeds); *Crawford v. Aultman & Co.,* 139 Mo. 262 (rule applied to trust deeds); *First Natl. Bank v. Rohrer,* 138 Mo. 369; *Gerardi v. Christie,* 127 S. W. 635 (doctrine affirmed incidentally); *Goodfellow v. Stillwell,* 73 Mo. 17; *Hagerman v. Sutton,* 91 Mo. 519; *Logan v. Smith,* 62 Mo. 455 (leading case in Missouri); *Patterson v. Booth,* 103 Mo. 402.

Nebraska.—*Cheney v. Janssen,* 20 Neb. 128 (incidentally affirms the rule); *Doll v. Hollenbeck,* 19 Neb. 639; *Mathews v. Jones,* 47 Neb. 616; *Webb. v. Haselton,* 4 Neb. 308 (principal case in Nebraska).

New Hampshire.—*Paige v. Chapman,* 58 N. H. 333.

New York.—*Gould v. March,* 1 N. Y. 566.

North Carolina.—*Coor v. Spicer,* 65 N. C. 401.

North Dakota.—*St. Thomas First Natl. Bank v. Floth,* 10 N. D. 281.

Oklahoma.—*Smith v. Taliaferro,* 23 Okla. 411.

South Carolina.—*Dearman v. Trimmier,* 26 S. C. 506 (holds that the running of the statute of limitations on the note does not bar foreclosure of the mortgage, but it is treated as a *chose in action* after note is barred by the statute).

South Dakota.—*Berry v. Stover,* 20 S. D. 459.

Tennessee.—*Nashville Trust Co. v. Smythe,* 27 L. R. A. 663.

Texas.—*Van Barkleo v. S. W. Mfg. Co.,* 39 S. W. 1085.

United States.—*Carpenter v. Longan.* 16 Wall. 271 (leading case in United States); *New Orleans Canal & Bkg. Co. v. Montgomery,* 95 U. S. 16.

Wisconsin.—*Anderson v. Hart,* 17 Wis. 297; *Bange v. Flint,* 25 Wis. 544;

Court, followed by the lower federal courts, is also very emphatic in

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Connell v. Hichens, 11 Wis. 353; *Croft v. Bunster,* 9 Wis. 503; *Crosby v. Raub,* 16 Wis. 645; *Fisher v. Otis,* 3 Pinney 78; *Kelly v. Whitney,* 45 Wis. 110; *Mack v. Prang,* 104 Wis. 1; *Martineau v. McCallum,* 3 Pinney 455 (leading case in Wisconsin); *Stillwell v. Kellogg,* 14 Wis. 461.

In the following states the existence of the rule may be of some doubt, but by *dictum* the majority rule seems to be preferred:

Alabama.—See *Hart v. Adler,* 109 Ala. 467; *Jordan v. Thompson,* 117 Ala. 468; *Lehman v. Tallahase Mfg. Co.,* 64 Ala. 567.

California.—*Taylor v. Jones,* 131 Pac. 114.

Louisiana.—Some doubt exists as to which rule is in force in Louisiana. Jones in his work on Mortgages, Vol I, Art. 838, and Black in his article on Mortgages in 27 Cyc. 1324, place Louisiana as supporting the minority rule. Some cases cited by each, while stating the minority doctrine, are not squarely in point and are not direct holdings. In *Bouligney v. Fortier,* 17 La. 121, cited by Black in Cyc., while the court does say "that the act of mortgage is not a negotiable instrument, and unlike the note which it secured when assigned is subject to all equities between the original parties," the case is peculiar on its facts and it is doubtful whether the holding is parallel to the usual cases supporting the minority rule.

Equitable Sec. Co. v. Talbert, 49 La. Ann. 1393, cited by Jones in his work on Mortgages, Vol. I, Art. 838, as supporting the minority rule, makes a similar statement to the one found in *Bouligney v. Fortier, supra,* but it does not appear to be a clear holding. Both cases grew out of transactions involving paraphernal funds of the wife.

On the other hand, a number of cases indicate that the contrary doctrine has been adopted in Louisiana, particularly so in view of the fact that the leading case in the United States, of *Carpenter v. Longan,* has been cited with approval by the Louisiana court. In *State Natl. Bank v. Flathers,* 45 La. Ann. 75, the court held that the defense of payment by mortgagor to mortgagee could not be raised against the assignee, the court saying "this court has deliberately held that a *bona fide* holder of negotiable note before maturity secured by mortgage cannot be defeated in his mortgage rights by secret equities between the original parties existing before or arising after its execution of which the act nor the public record afforded any notice and of which he had no actual notice. This was emphatically held in *Carpenter v. Allen,* 16 La. Ann. 435, and the decision was not based on the principle of negotiability of a mortgage but on different principles. (1) Because, when one of two innocent parties must suffer, the law throws the loss on him by whose negligence or fault damage is occasioned, and (2) because a mortgage is a real right created only by observance of the forms of law required to be recorded like sales of real estate, such registry being required for the protection of third parties who are entitled to look for protection and without actual notice are not required to look beyond it." The court then says, "A like rule was enforced in *Carpenter v. Longan," supra.*

See also the following cases which seem to support the majority rule: *Dreyfus v. Childs,* 48 La. Ann. 872; *Davis v. Welch,* 128 La. 785; *Carpenter v. Allen,* 16 La. Ann. 435; *Gardner v. Maxwell,* 27 La. Ann. 561; *Taylor v. Bowles,* 28 La. Ann. 294; *Billgery v. Ferguson,* 30 La. Ann. 84; *Schepp v. Smith,* 35 La. Ann. 1.

Reference to the Louisiana cases has been purposely avoided in the text in order to prevent any possible confusion with principles peculiar to that state.

Maine.—*Pierce v. Faunce,* 47 Me. 507 (case of latent equities); *Sprague v. Graham,* 29 Me. 161.

New Jersey.—*Maggie v. Reynolds,* 51 N. J. Eq. 113.

In the following states the case apparently has not arisen: Arizona, Arkansas, Connecticut, Delaware, Florida, Georgia, Idaho, Maryland, Mississippi, Montana, Nevada, New Mexico, Oregon, Pennsylvania, Rhode Island, Utah, Vermont, Virginia, Washington, West Virginia, Wyoming.

affirming the soundness of the rule.[10] The minority rule, by which the assignee before maturity of a note and mortgage takes subject to all personal defenses between the original parties, is supported by Illinois, Minnesota and Ohio.[11]

The Supreme Court of Michigan in 1843, in *Reeves v. Scully,*[12]

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10. Federal cases.—*Beals v. Neddo,* 2 Fed. 41; *Hayden v. Snow,* 14 Fed. 70; *Hamilton v. Fowler,* 99 Fed. 18; *Jarvis-Conklin Trust Co. v. Willhoit,* 84 Fed. 14; *Myers v. Hozzard,* 50 Fed. 155 (rule applied to chattel mortgages); *O'Rourke v. Wahl,* 109 Fed. 266; *Swett v. Stork,* 31 Fed. 858 (mortgage on real estate in Illinois; federal rule and not Illinois rule applied).

All follow *Carpenter v. Longan,* 16 Wall. 271.

11. Illinois.—*Olds v. Cummings,* 21 Ill. 188 (leading case). On the facts it may be doubted whether the principal discussion is an absolute holding, but it is regarded as such in subsequent cases); *Kleeman v. Frisbie,* 63 Ill. 482 (applies the rule to deeds of trust); *Bryant v. Vis,* 83 Ill. 11 (applies the rule to chattels); *Hodgson v. Glass Co.,* 156 Ill. 397 (applies the rule to chattels); *Colhour v. State Savings Institution,* 90 Ill. 152 (holding that the assignee does not take subject to defenses arising out of collateral transactions between mortgagor and mortgagee); *P. & S. R. R. Co. v. Thompson,* 103 Ill. 187 (rule not applied to negotiable railroad coupon bonds intended to circulate on the market); *Miller v. Larned,* 103 Ill. 562 (held, rule does not apply when mortgage is given to secure an accommodation note); *Shippen v. Whittier,* 117 Ill. 282 (affirms the rule incidentally); *Towner v. McClellan,* 110 Ill. 542; *McAuliffe v. Reuter,* 166 Ill. 491 (deed of trust to a homestead; unsuccessful attempt to bring the case within the exception. Assignee not protected on ground stated in *P. & S. R. R. Co. v. Thompson,* as an exception to the general rule of *Olds v. Cummings*); *Buehler v. McCormick,* 169 Ill. 269 (another attempt to bring the case within the exception. Assignee not protected on ground of estoppel); *Chicago Title & Trust Co. v. Aff,* 183 Ill. 91 (case not within exception as contended); *Romberg v. McCormick,* 194 Ill. 204 (deed of trust); *Boulton v. Cameron,* 205 Ill. 50 (case not within the exception laid down in *Miller v. Larned*).

In Jones & Addington Ann. Stat. Ill., Vol. IV, Sec. 7589, an act appears, Laws Ill. 1901, p. 248, which makes mortgages, trust deeds, etc., exempt from defenses to the same extent as the note which it secures. The editors say, however, that there is doubt whether the act was ever passed by the House of Representatives. The act is not found in Hurd's Revised Statutes. Strange to say, the act was not referred to by the attorneys nor the court in the two cases arising since the act is supposed to have been passed. See *Romberg v. McCormich* and *Bouton v. Cameron.*

Minnesota.—*Johnson v. Carpenter,* 7 Minn. 120 (leading case in Minnesota); *Hostetter v. Alexander,* 22 Minn. 559 (an unsuccessful attempt to overrule *Johnson v. Carpenter,* on the reasoning in *Carpenter v. Longan*); *Oster v. Mickley,* 35 Minn. 245 (applies the rule to chattel mortgages); *Redin v. Branhan,* 43 Minn. 283; *Smith v. Parsons,* 55 Minn. 520; *Watkins v. Goessler,* 65 Minn. 118.

Ohio.—*Bailey v. Smith,* 14 Ohio St. 348. Leading case in United States.

The Colorado courts supported the minority rule in its first opinion, but on reversal by the United States Supreme Court, the attitude of the court changed and the majority rule is the law of that state today.

Jones in his work on Mortgages, Vol. I, Sec. 838, places Oregon in line with the minority doctrine and cites the single case of *Corbett v. Woodward,* 5 Sawyer 403, 11 Chicago Legal News 246. Only the headnote appears in the Chicago Legal News, but it is doubtful whether the case really stands for the minority doctrine. Moreover, it is a United States Circuit Court decision.

12. Walker's Ch. Rep. 248.

was the first to pass upon the question. The assignee of the note and mortgage in a foreclosure suit, was held not to be affected by the equities between the mortgagor and mortgagee, thus laying the foundation for what has now come to be the prevailing doctrine. In this connection it is interesting to note that the court in its opinion simply states the holding. No authorities are cited nor does the theory underlying the decision clearly appear.[13] The Wisconsin court in 1850, in *Fisher v. Otis*,[14] by way of *dictum* only, asserted the same doctrine. The court did not refer to *Reeves v. Scully*. Two years later the Supreme Court of Wisconsin in *Martineau v. McCollum*,[15] actually held that the assignee took free from equities, but, strange to say, neither the Michigan holding nor the previous *dictum* of the Wisconsin court in *Fisher v. Otis* were cited in the opinion, the holding being based on the theory that an assignment of the debt carries with it the security.[16] Again in *Croft v. Bunster*,[17] the same rule was announced, the holding being based, first, on the theory that the mortgage is the incident to the debt, and, second, on the theory that the assignee should have coextensive rights in law and equity against the mortgagor.

The Minnesota court in 1862,[18] after an examination of the previous Michigan and Wisconsin holdings and a rejection of them on the ground that they showed but slight investigation, held that the assignee took subject to personal defenses; the theory being that a mortgage was essentially a *chose in action* and remained so even when assigned with a negotiable promissory note. The court recog-

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13. The entire opinion is as follows: "The decree must be entered for the amount of the note and mortgage. C, as *bona fide* endorsee of the note, was not affected by the equities between A and B. It would have been otherwise if a bond instead of a note had been given with the mortgage."

14. 3 Pinney 78. This case has been cited a number of times as laying down the rule, but it is scarcely in point for the assignment was made expressly subject to the rights of the mortgagor. The *dictum* was, however, a strong one.

15. 3 Pinney 455.

16. Citing *Morris v. Floyd*, 5 Barb. 132; *Cooper v. Ullman*, 1 Walker's Ch. 251; *Southerlin v. Mendum*, 5 N. H. 420; *Cutler v. Hanen*, 8 Pick. 480; *Porter v. Millet*, 9 Mass. 101; *Swint v. Horn*, 1 N. H. 332; none of which are in point. The cases cited do sustain the proposition that an assignment of the debt carries with it the security but none go farther than this.

It was strongly urged in the case that since an assignee of a bond and mortgage took the mortgage subject to equities, that the assignee should also take subject to equities when the mortgage secured a negotiable note. But the court, in speaking through Knowlton, J., said, "Now I hold that these very authorities tend to prove that the defense is not good as to negotiable notes. The principle governing such a case is that the mortgage is only an incident to the debt."

17. 9 Wis. 503.

18. *Johnson v. Carpenter*, 7 Minn. 120.

nizes the doctrine that a mortgage is an incident to the debt, and that an assignment of the debt carries the mortgage with it, but the court lays stress upon their contention that an assignee should not for this reason be allowed "to rely on the priviliged character of the note to ensure him the advantage of the mortgage." The court refers to the contrary holding as working a startling innovation in the law.

Massachusetts in 1863,[19] on slight examination into the real nature of the transaction and without reference to the Michigan and Wisconsin cases nor to the contrary holding in Minnesota, held in accord with the majority rule, apparently because they "knew of no principle or authority which makes the mortgage less valid than the note in the plaintiff's hands." In the same year, 1863, the whole question was given a most thorough examination by the Ohio court in *Bailey v. Smith,*[20] a case in which with the possible exception of *Carpenter v. Longan,*[21] the problem received the most careful analysis of any of the numerous decisions on this question. The court held that the assignee of the note and mortgage took the mortgage subject to the personal defenses which the mortgagor had against the mortgagee, thus placing the decision in accord with the previous Minnesota case. Michigan and Wisconsin cases were commented upon but the theories relied upon rejected as unconvincing. The court insisted that a mortgage had always been regarded as a *chose in action* and while recognizing that a mortgage is only the incident of the debt, strongly denied the soundness of the conclusion drawn from it by the Michigan and Wisconsin courts. "It certainly has never been thought to be within the province of the court to determine what instruments should be taken from the list of mere *choses in action* and clothed with the attributes of negotiability," asserts the court. Other collateral securities accompanying negotiable notes have never been regarded as themselves negotiable and the court calls especial attention to the case of guaranties indorsed on negotiable notes which have never been treated as in any sense negotiable, although just as much incident to the primary obligation as a mortgage. To the argument suggested by the Wisconsin court in *Croft v. Bunster*[22] that the remedies of the assignee should be in law and equity coextensive, the Ohio court affirms that there is a wide distinction between allowing judgment and execution at law

19. *Taylor v. Page,* 6 Allen 86.
20. 14 Ohio St. 398.
21. 16 Wall. 271.
22. 9 Wis. 503.

and in the foreclosure of a mortgage in equity. The position of the mortgagor is not the same. If the mortgage covered exempt property, such as a homestead, a judgment at law on the note would be valueless while such property could be sold under the mortgage. The rights of third parties, other lien holders, might be affected in a number of ways. But even granting, says the court, that the mortgagor would have no interest in withdrawing the mortgaged premises from liability to satisfy the assignee's claim, still the liability that the property eventually may be sold on execution after a binding judgment on the note, furnishes no authority for changing the legal character and incidents of the mortgage deed which is essentially a *chose in action.* It would appear that this latter point is one frequently overlooked by courts which have adopted the contrary rule.

In the same year, 1863, the Supreme Court of Illinois, in *Olds v. Cummings,*[23] came to the same conclusion as the Minnesota court in *Johnson v. Carpenter,*[24] and the Ohio court in *Bailey v. Smith,*[25] though neither of these cases were cited in the opinion. The basis for the holding is practically the same as that advanced in the two earlier cases. The theory of *Olds v. Cummings* seems to be that "he who buys that which is not assignable at law takes it subject to all infirmities to which it is liable in the hands of the assignor."[26] Although dissented from by one judge, the Colorado court in *Longan v. Carpenter,*[27] in 1870, reached the same conclusion as did the Illinois court. While recognizing that a mortgage was incident to the note the court laid emphasis upon its separate and independent character as a *chose in action,* and as such was subject to personal defenses between the original parties.

Up to this point with the exception of the early cases in Michigan and Wisconsin, and passing over the rather unsatisfactory North Carolina case of *Coor v. Spicer*[28] in 1871, the present minority rule was being adopted. Minnesota in 1862 was the first, followed by Ohio and Illinois in 1863 and Colorado in 1870. It is interesting to observe that in each case, with the exception of the Colorado case of *Longan v. Carpenter,* in which *Olds v. Cummings* was relied upon, the holding was reached by independent reasoning.

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23. 21 Ill. 188.
24. 7 Minn. 120.
25. 14 Ohio St. 348.
26. This statement has been quoted by the Illinois court in *Sumner v. Waugh,* 50 Ill. 531, and in *White v. Southerland,* 64 Ill. 181, as the doctrine of *Olds v. Cummings.*
27. 1 Colo. 205.
28. 65 N. C. 402. Case holds with the majority. Opinion very short. No authorities cited and may depend somewhat on a statute.

Then came the leading case, reaffirming the present majority rule. It was the case of *Carpenter v. Longan,*[29] in which the Colorado case of *Longan v. Carpenter,* on appeal to the United States Supreme Court, was reversed. The doctrine of the Colorado case and that of *Bailey v. Smith* was rejected. The Michigan and Wisconsin cases were regarded as announcing the true principle. So vigorous was the opinion that the courts before which the question has been subsequently presented have followed the holding with but slight examination into the relative merits of the opposing lines of reasoning. The court makes no reference to the Colorado, Illinois or Minnesota cases. Considering *Bailey v. Smith,* the court asserts that the Ohio opinion was based chiefly on the ground that notes are negotiable by virtue of statute only, while there is no such statutory provision as to mortgages, and that hence the assignee takes the latter as he would any other *chose in action,* subject to all equities in the hands of the original holder, to which argument the United States Supreme Court replies that "all authorities are agreed that the debt is the principal theory and the mortgage is the accessory. Equity puts the principal and accessory upon a footing of equality and gives to the assignee of the evidence of the debt the same rights as to both," an answer which it may be argued assumes the very point at issue. But further to support the position the court says that a contrary doctrine in allowing judgment and execution on the note and not foreclosure of the mortgage involves a strange anomaly but the court in this connection makes no reference to the disappearance of the anomaly when the mortgaged premises happen to be upon exempt property[30] or where the rights of prior lien holders are involved. While the United States Supreme Court in referring to this so-called anomaly regrets that "such an excrescence ought not be permitted to disfigure any system of enlightened jurisprudence," it is submitted that there is no particular anomaly in holding that one's cause of action at law might be productive of results very different from those produced by another cause of action in equity although both arose from the same transaction.

The force of the reasoning and the fact that it came from the highest court in the land may account for the refusal of later courts to go into the general question with any degree of thoroughness. A long line of decisions has followed in which reliance is chiefly

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29. 16 Wall. 273.
30. See *McCauliff v. Reuter,* 166 Ill. 491, deed of trust to homestead.

placed on the United States Supreme Court case. New York[31] adopted the rule in 1874.

In 1876 the courts of Iowa,[32] Missouri[33] and Nebraska[34] held with the majority, and in each, *Carpenter v. Longan,* the United Supreme Court case, was cited with approval and to noticeable extent with reliance upon it. Kentucky[35] followed in 1897; New Hampshire[36] in 1878; Indiana[37] in 1880; and the federal courts[38] in 1880; Kansas[39] in 1881; South Carolina[40] in 1886; Tennessee[41] in 1895; Texas[42] in 1896; North Dakota[43] in 1901; and Oklahoma[44]

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31. *Gould v. Marsh,* 1 N. Y. 566, citing *Carpenter v. Longan.* The court to some extent relied on *Pierce v. Faunce,* 47 Me. 507, which is not in point here. The question was one of secret equities of third parties, the holding being that the assignee took free from these equities. The rights of an assignee to take free from equities possessed by the original parties was not involved.

32. *Kean & Co. v. Morris Case & Co.,* 42 Ia. 549. Court quoted from *Carpenter v. Longan,* but made no comment on *Olds v. Cummings* which was cited in the brief of counsel.

33. *Logan v. Smith,* 62 Mo. 455. *Carpenter v. Longan* cited with approval. Cases representing the minority rule not cited.

34. *Webb v. Hazelton,* 4. Neb. 308. Court cites Michigan and Wisconsin cases and *Carpenter v. Longan.* In discussing *Bailey v. Smith,* the court says the doctrine there laid down might be applicable in a title theory state but not in a lien theory state such as Nebraska.

35. *Duncan v. Louisville,* 13 Bush. 378. *Carpenter v. Longan* not cited. Theory of the Illinois cases rejected, the court saying that it should make little difference to the mortgagor whether he pays on a judgment at law or on foreclosure of the mortgage.

36. *Paige v. Chapman,* 58 N. H. 333. Proceeds on the theory that the mortgage is incident to the debt. *Carpenter v. Longan* and *Taylor v. Page* (Mass.) cited, but without comment. None of the opposing cases cited.

37. *Gobbert v. Schwartz,* 69 Ind. 450. *Carpenter v. Longan* and *Logan v. Smith* (Mo.) cited, but without comment. Cases representing minority rule not cited.

38. *Beals v. Nedda,* 2 Fed. 41; *Hayden v. Snow,* 14 Fed. 70; *Mersman v. Wergo,* 3 Fed. 378; *Hayden v. Drury,* 3 Fed. 782. A number of cases have followed.

39. *Burhaus v. Hutcheson,* 25 Kans. 435. Decision based largely on *Carpenter v. Longan.* This decision is practically the basis of the holding.

40. *Dearman v. Trimmier,* 26 S. C. 506. Court quotes liberally from *Carpenter v. Longan.* This decision is practically the basis of the holding. Opposing cases not considered.

41. *Nashville Trust Co. v. Smyth,* 27 L. R. A. 663. Court quotes extensively from *Carpenter v. Longan* and "does not deem it necessary to go into a more extended citation or discussion." Cases representing the minority rule not considered.

42. *VanBurkleo v. Southwestern Mfg. Co.,* 39 S. W. 1085. Court concedes that the question is not free from doubt, but concludes that the weight of authority settles the proposition. Court quotes from *Carpenter v. Longan,* No citation to opposing cases.

43. *First National Bank v. Flath,* 10 N. D. 281. While citing the Illinois cases, the court quotes approvingly from *Carpenter v. Longan.*

44. *Smith v. Taliaferro,* 23 Okla. 411. Decided largely on the authority of *New Orleans Canal Company v. Montgomery,* 95 U. S. 16, which simply reannounced the doctrine of *Carpenter v. Longan.*

in 1909. In all of these cases *Carpenter v. Longan* is cited with approval. A reading of this long line of decisions followed usually by a number of cases in each jurisdiction, discloses two important facts: first, that this decision of the United States Supreme Court, if not actually dictating later holdings has materially influenced every court that has passed upon the point under discussion since 1872; and second, that there has been a marked indisposition on the part of the courts to consider the opposing arguments presented by the decisions in Minnesota, Ohio, Illinois and Colorado, and a consequent failure to go into any independent and original analysis of the transaction. With all deference to the able courts that have passed upon the question subsequent to the decision in *Carpenter v. Longan,* it may not be altogether inappropriate to say that these decisions rest on sound principles only in so far as the case of *Carpenter v. Longan* is based on sound principles.

To summarize: the origin and development of the opposing doctrines reveal this situation: both doctrines are strictly of American origin and are confined to America, the rule protecting an assignee before maturity of a note and mortgage to the same extent on foreclosure of the mortgage as on an action on the note was first announced by the Supreme Court of Michigan, without argument, in the case of *Reeves v. Scully*[45] in 1843, laid down independently by the Wisconsin court in very strong *dictum* in the case of *Fisher v. Otis*[46] in 1850, followed by a strong decision in *Martineau v. McCollum*[47] in 1852, and again by a very strong *dictum* in *Croft v. Bunster*[48] in 1859. The growth of the present majority doctrine stopped at this point.[49] Beginning with the decision by the Minnesota court in *Johnson v. Carpenter,* wherein the opposing doctrine was first announced, after examination into the reasoning of the contrary Michigan and Wisconsin cases, the present minority doctrine was being gradually extended by *Bailey v. Smith*[50] in 1863, *Olds v. Cummings*[51] in 1863, and *Longan v. Carpenter*[52] in 1870. Then came the leading case of *Carpenter v. Longan*[53] in 1872, in

45. Walker's Ch. 288.
46. 3 Pinney 78.
47. Id., 455.
48. 9 Wis. 503.
49. With the exception of Massachusetts, which in *Taylor v. Page,* 1863, held in accord with the Michigan and Wisconsin cases, but without reference to them, and on very slight examination into the question generally.
50. 14 Ohio St. 348.
51. 21 Ill. 188.
52. 1 Colo. 205.
53. 16 Wall. 273.

which the Supreme Court of the United States adopted the doctrine of the earlier Michigan and Wisconsin cases, which successfully checked the growth of the minority doctrine as expressed by the decisions in Minnesota, Ohio, Illinois and Colorado, and has furnished the foundation for the long line of decisions which today unquestionably constitute the weight of authority upon the proposition.

Theories Supporting the Majority Rule.—Six principal theories have been advanced by the courts in support of the majority rule, some generally relied upon, others, apparently, less controlling. First, the mortgage is an incident to the debt, and therefore partakes of the nature of the primary obligation; second, the mortgage is enforceable by the assignee, free from equities between the mortgagor and mortgagee because of the original contract itself; third, the rights of the assignee should be of as high an order in a court of equity as they are in a court of law; fourth, the assignee is entitled to protection as a *bona fide* purchaser; fifth, springs from the fundamental difference in the conception of a mortgage; sixth, the assignee should be protected because of public policy considerations.

The first, and perhaps the fundamental and controlling principle upon which the majority rule is founded, seems to be this: the debt secured is the principal thing, the mortgage is but the security for that debt—an incident, an accessory, to the primary obligation—the debt as a consequence importing its own character to the mortgage, and the assignee takes the security as he does the note, free from all equities, all personal defenses, existing between the original parties to the transaction. This doctrine has been asserted in some manner by practically every court that has adopted the majority rule.[54]

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54. *Carpenter v. Longan;* "All authorities agree that the debt is the principal and the mortgage the accessory. Equity puts the principal and accessory upon a footing of equality and gives the assignee of the evidence of the debt the same rights to both."

Hart v. Adler, 109 Ala. 467: "The mortgage is the incident of the note." Dictum only.

Gobbert v. Schwartz, 69 Ind. 450: "The debt secured is the principal thing and the mortgage is but the incident. It follows that the indorsee of the note secured by a mortgage takes the mortgage discharged from all equities to which the note may have been subject in the hands of the payee to the same extent as the note itself is discharged from such equities."

Lewis v. Kirk, 28 Kans. 363: "A mortgage in this state is only a security, only an incident of the debt which it is made to secure, and like all other securities, it follows the debt and partakes of its nature and character."

Watson v. Watson, 161 Mass. 96: "The mortgage follows the note, and if the holder can recover on the note he may avail himself of the mortgage."

Closely associated with the principal line of reasoning this further argument is advanced by a few courts: the assignee is entitled to protection by virtue of the contract obligations resting upon the mortgagor. The theory thus advanced, while it has not been analyzed to any great extent by the courts, seems to proceed as follows: the mortgagor, by giving a negotiable note to the mortgagee as payee has contracted to pay the mortgagee the face of the note. Springing from the law merchant and from the settled principle in the law of negotiable instruments today, the mortgagor has also contracted to pay to any subsequent holder in due course of the note the amount called for by the instrument, free from all personal defenses which he, as maker, might have against the payee—mortgagee. In other words, the principle invoked follows from the familiar one that the rights of every holder in due course of commercial paper subsequent to the payee spring from the original contract itself and not from the contract of the holder's immediate indorser or of any of the former secondary parties to the paper. Then comes the important element, the mortgagor has by contract hypothecated certain property to secure the performance of these two obligations, e. g., the one to the payee-mortgagee and the one

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Reeves v. Scully, Walker's Ch. (Mich.) 248: "An assignee of a mortgage as *bona fide* indorsee of the note, is not affected by the equities existing between the mortgagor and mortgagee. It would be otherwise if a bond, instead of a note, had been given with the mortgage."

Hagerman v. Sutton, 91 Mo. 519: "The mortgage being the incident it partakes of the negotiability of the principal, to wit, the note."

Webb v. Hazelton, 4 Neb. 308: "The mortgage is a mere incident to the debt and passes with it * * * and the assignee takes it and the security free from equities between the original parties."

Paige v. Chapman, 58 N. H. 333: "A mortgage is incident to the debt secured by it and a transfer of the note or other evidence carries the mortgage with it."

Gould v. Marsh, 1 Hun. 566: "The mortgage as the incident passed with the transfer of the debt."

First Natl. Bank v. Flath, 10 N. D. 281: "A mortgage securing a negotiable note shares the same immunity from defenses between the original parties as the note secured."

Dearman v. Trimmier, 26 S. C. 506: "The debt is the principal thing * * * the note carries with it the mortgage impressed with the qualities incident to the note."

Fischer v. Otis, 3 Pinney (Wis.) 78: "The mortgage * * * is an incident to the note and may be enforced by the holder in spite of any existing equities between the mortgagor and mortgagee."

First Natl. Bank v. Bryan, 62 Ia. 42: "*Bona fide* indorsee before maturity of a note secured by a mortgage takes the mortgage as he takes the note, free from defenses to which it is subject in the hands of the mortgagee."

VanBurkleo v. Southwestern Mfg. Co., 39 S. W., 1085 (Tex.): "Purchaser for value of negotiable note before maturity secured by mortgage takes the security free from the equitable interest of the third party of which no notice is brought home to him."

to subsequent holders of the note. Therefore, the argument seems to be that the mortgagor has contracted to pay the face of the note to any subsequent holder in due course and, since the mortgage is given to secure the performance of this contract, the assignee of the note and mortgage should be allowed to enforce the entire contract according to its original tenor.[55]

A third line of reasoning, while perhaps less important in furnishing a basis for the doctrine, has had its influence on some courts and it may be that all are moved somewhat by it, whether it be actually expressed in the decision or not. There seems to be a feeling on the part of the courts which have adopted the majority rule that the rights of the assignee should be coextensive in law and equity; that is, the assignee should be entitled to the same rights on bill to foreclose the mortgage as he admittedly has to execution on the judgment secured in a court of law on the note. The Supreme Court of the United States in *Carpenter v. Longan,* declares that a contrary holding involves a strange anomaly. Supposing that under the minority rule the assignee's suit to foreclose the mortgage is dismissed because the mortgagor had a good defense of payment against the mortgagee, in spite of this, the court says, the mortgagee could still bring an action of law on the note, obtain a judgment irrespective of the defense of payment, take execution, and if need be, actually sell the mortgaged premises on this process. Therefore, the argument is, why not allow the assignee this right in the first instance on the bill to foreclose, and the court adds, incidentally avoid circuity of action.[56]

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55. It should be stated, however, that this argument has not been presented by any court except in so far as contained in the following quotations, which are the only expressions found which seem to indicate this line of reasoning.

In *Carpenter v. Longan,* 16 Wall. (U. S.) 271, the court says: "To let in such a defense against such a holder would be a clear departure from the *agreement of the mortgagor,* to which the assignee subsequently in good faith became a party." The Missouri court has twice expressed a similar argument. In *Logan v. Smith,* 62 Mo. 455, the court said: "The mortgage itself is not a negotiable instrument, and cannot be transferred as such, but the indorsee of the note acquires a right to the security afforded by it *by reason of the stipulations contained in the mortgage itself* that the property conveyed by it may be subjected to the payment of the full amount which the payee as indorsee shall be entitled to receive as holder of the note." And again in *Crawford v. Aultman & Co.,* 139 Mo. 262: "The rights of the parties are to be determined *by the relation they sustain to the contract to be performed* and not by the nature of the security given for its performance."

56. *Croft v. Bunster,* 9 Wis. 503. The court argues that when the nature of the instrument evidencing the debt and the circumstances of the transfer are such that in a suit at law upon it against the mortgagor the assignee can enforce its payment regardless of any equity existing between

A fourth line of reasoning suggested by the Massachusetts, New York[57] and the United States Supreme Courts leads to the protection of the assignee on the theory that the assignee is a *bona fide* purchaser and has the right to rely on the record. "It is the policy of our law that a purchaser of land by examining the records may ascertain the title of his grantor," declares Mr. Justice Holmes in *Watson v. Wyman.*[58] Again in *Carpenter v. Longan*[59] the court, quoting with approval the language of the Maine court in *Pierce v. Faunce,*[60] affirms that "the assignee of a mortgage is on the same footing with a *bona fide* mortgagee. In all cases the reliance of the purchaser is upon the record, and when that discloses an unimpeachable title he receives the protection of the law as against unknown and latent defects." The New York court also adds that "the assignee is entitled to the rights of a *bona fide* purchaser in respect to the mortgage."

A fifth argument, while it has never been relied upon in any strict sense, has been offered by the Nebraska court in *Webb v. Hazelton*[61] as a possible explanation for the minority doctrine and as a justification for the majority rule adopted in that state. "In states like Ohio," suggests the Nebraska court, "where it is held that after condition broken the legal estate is vested in the mortgagee, a mortgage may perhaps be properly regarded as a *chose in action* and available only for what is honestly due from the mortgagor to the mortgagee. But in this state the mortgagee is not seized of the freehold either at law or equity after condition broken." The inference seems to be, therefore, that the minority rule may be justifiable in states where the title theory of a mortgage obtains but not in states where the lien theory prevails.

And last is the broader and somewhat indefinite foundation of

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the mortgagor and mortgagee, he should have the same rights in equity. In *Duncan v. Louisville,* the Kentucky court says: "In any event the mortgagor is bound to pay the entire debt to the holder of the note, and it can be of little moment to him whether he pays it on a judgment at law or by the enforcement of a mortgage."

As to the argument that such procedure avoids circuity of action, it is doubtful whether this is a proper example for the application of this equitable principle.

57. *Gould v. Marsh,* 1 N. Y. 566.

58. 161 Mass. 96.

59. 16 Wall. 271.

60. 47 Me. 507. The argument of the court here is with reference to latent equities possessed by parties who were strangers to the mortgage transaction. There may well be some question as to its proper application to a case of this kind where the equity is possessed by the mortgagor himself and not a latent equity held by a third party.

61. 4 Neb. 308.

public policy referred to by the New York court in *Gould v. Marsh*,[62] wherein the court "recognizes that a purchaser of a *chose in action* must abide by the case of the person from whom he buys, but as Judge Allen states it in *Schaefer v. Reilly*,[63] the rule admits of exceptions adopted from motives of public policy either to promote the negotiability of commercial instruments or to prevent fraud.[64]

Exceptions to the Majority Rule.—Before passing to a consideration of the opposing theories supporting the minority rule, a few exceptions, or, more accurately speaking, apparent exceptions, to the majority rule may be noticed. While the general rule frees the assignee from all defenses possessed by the mortgagor, the assignee is not protected, first, when the mortgagor had no title to the property mortgaged, second, when the mortgage is on a homestead and the signature of the wife to the mortgage deed was obtained by duress.

With reference to the first exception, Michigan has held[65] that a purchaser of a note and mortgage on land to which the mortgagor had no title at the time, which fact was disclosed by the records, is entitled to no benefit under the mortgage. Second, Iowa[66] and Kansas[67] have held, in very similar cases, that the doctrine had no application to the homestead situation above described.

Theories Supporting the Minority Rule.—Three theories have been advanced to support the minority rule, the first being the principal one, the remaining two subordinate. First, a mortgage is a *chose in action* and remains such though assigned with a negotiable note, and therefore the assignee takes only the interest which his assignor had; second, the mortgagor is entitled to protection under the principle that of two equal equities the one oldest in time should prevail; third, the mortgagor should be protected under the record-

62. 1 N. Y. 566.
63. 50 N. Y. 61.
64. Illinois, which follows the minority rule, seems to recognize the force of this argument in the case of *P. S. R. R. Co. v. Thompson*, 103 Ill. 187, wherein the court withdraws from the operation of the rule in *Olds v. Cummings*, the case of negotiable railroad bonds secured by trust deed, because, as the court says, "the doctrine of *Olds v. Cummings* has no application to deeds of trust given to secure railroad coupon bonds intended to be thrown on the market and circulated as commercial paper." This holding represents a limitation of the minority doctrine in Illinois.
65. *Lockwood v. Nobel*, 113 Mich. 418.
66. *First National Bank of Nevada v. Bryan*, 62 Ia. 42.
67. *Berry v. Berry*, 57 Kan. 691. May have been dictated somewhat by the Kansas statute, which provides that a homestead shall not be alienated without the joint consent of husband and wife. The theory of the case, in which the Iowa decision is cited as being in accord, seems to be that there never was a mortgage because of the lack of the wife's consent.

ing acts, because the recording of an assignment cannot be deemed notice to prior parties.

First, the fundamental basis for the minority doctrine seems to be as follows: A mortgage is essentially a *chose in action;* the majority doctrine, in effect, makes a mortgage negotiable; *choses in action* are only negotiable by virtue of the law merchant or modern statutes; courts possess no authority to select a particular class of *choses in action* and endow them with the incidents of negotiability; consequently a mortgage, remaining a *chose in action,* he who buys it takes it subject to all the infirmities to which it is liable in the hands of the assignor. This process of reasoning seems to go to the foundation of the minority rule.[68] The courts in advancing this line of argument, while recognizing that a mortgage is only incident to the debt, still regard the mortgage as so far independent and separate from the primary obligation to which it is attached, that it is still, as it always has been nothing but a *chose in action,* and therefore retains all of the attributes thereof. At this point the real fundamental clash in the theories of the majority and minority rule occurs. The majority rule proceeds on the theory that the mortgage is so closely associated with and dependent upon the primary obligation, e. g., the note, that it has lost its own individual characteristics as a mere *chose in action,* and has taken over, by virtue of this close association, the characteristics of the primary obligation, e. g., negotiability. The minority rule proceeds on the directly

68. *Johnson v. Carpenter,* 7 Minn. 120: "The rule as we collect it from the books is that where a debt is secured by a mortgage on real estate and also by a negotiable promissory note, the mortgage is a chose in action as between the mortgagor and any subsequent assignee and is taken subject to the state of accounts between the mortgagor and the mortgagee at the time of the assignment. The mortgage is an incident of the debt and whoever owns the latter is entitled to the benefit of the former to enforce payment, but he cannot rely on the privileged character of the note to ensure him the advantage of the mortgage. * * * It appears to us that it would be making a startling innovation upon the long settled policy of the law of real estate should we concede to any security that carries with it an interest in or lien upon lands the volatile and transitory attributes of a mere promise to pay money." While the court refers here to mortgages on land, the rule has been nevertheless applied to chattel mortgages by the same court, see *Oster v. Mickley,* 35 Minn. 245.

Olds v. Cummings, 21 Ill. 188: "A mortgage is a *chose in action.* He who buys that which is not assignable at common law takes it subject to all infirmities to which it was liable in the hands of the assignor."

Bailey v. Smith, 14 Ohio St. 348: "The universally acknowledged doctrine from the case of *Davies v. Austin,* 1 Ves. Jr., 247, 1790, has been that a mortgage is regarded as a *chose in action.* * * * It has certainly never been thought to be within the province of a court to determine what instrument shall be taken from the list of mere *choses in action* and clothed with the attributes of negotiability." The assignee takes only the interest of his assignor.

Longan v. Carpenter, 1 Colo. 205, contains similar reasoning.

opposite theory that while the mortgage is closely associated with and dependent upon the primary obligation, it has not thereby lost its own individual characteristics as a mere *chose in action,* and has not acquired any of the characteristics of the principal obligation.

A second argument relied upon is the maxim of equity that of two equal equities, the oldest in time should prevail. Illinois is the only state that has advanced this theory, but the court in two decisions,[69] following *Olds v. Cummings,* goes so far as to say that "the principle underlying *Olds v. Cummings* is that the original mortgagor has equities that are older and superior to any possessed by the assignee of the notes secured, and on the doctrine that the oldest equity prevails, the mortgagor has been let in to make defense to the mortgage in the hands of the equitable assignee as he could against the assignor."

A third doctrine springing from the recording acts is cited by the Minnesota court, in *Johnson v. Carpenter,* to support the minority rule. By statute, the recording of an assignment of a mortgage is not to be deemed notice of such assignment to the mortgagor so as to invalidate any payments made by the mortgagor to the mortgagee. At least as to the defense of payment, Minnesota holds that the mortgagor may always pay his mortgage debt to the mortgagee, whether the mortgage has been assigned or not, if he pays in good faith and without actual notice of the assignment. In such a case he will be protected.

The foregoing are practically the only constructive theories presented in support of the minority rule. In addition to these, however, the courts, particularly Ohio, in *Bailey v. Smith,*[70] have called attention to certain principles and advanced them in refutation of some of the premises upon which the majority rule is constructed.

First, to the fundamental proposition upon which the majority rule rests, that the mortgage is an incident to the debt and therefore partakes of the nature of the primary obligation, the Ohio court makes this general answer, "that it has never been thought to be within the province of a court to determine what instruments should be taken from the list of mere *choses in action* and clothed with the attributes of negotiability." The Ohio court makes a further and more particular answer to the same contention. Attention is called to the fact that there is a variety of collateral agreements which are made to secure negotiable notes. From these collateral agreements, mortgages alone have been treated as in any sense negotiable. The

69. *Sumner v. Waugh,* 56 Ill. 513; *White v. Sutherland,* 64 Ill. 181.
70. 14 Ohio St. 396.

court cites as an illustration, the case of collateral guaranties endorsed on notes and affirms that these securities, though incident to the note, have never been treated as negotiable. On this point, quoting the language of Mr. Justice Savage, in a New York case,[71] the court relies on this statement there made, "Promisory notes are negotiable only by virtue of the statute; but this negotiable quality is not extended to any other instrument relating to the note," and upon the holding, in a later New York case,[72] that a separate guaranty to a note is not itself a negotiable instrument. That is the court argues, in the first place courts possess no authority to clothe mortgages with the incidents of negotiability, and, second, the majority courts in doing so are inconsistent, because other collateral securities such as guaranties have never been and cannot be treated as negotiable even though they be closely associated with such an instrument.

Second, to the third argument urged by the majority courts that since after judgment on the note the assignee may take execution against the property of the mortgagor, his rights in equity should be of as high order as they are at law, it being urged that it can make no difference to the mortgagor on what process his property is taken, the answer is made that it does make a difference, for the rights of third parties holding prior liens on the property may be affected; and again that it makes a difference to the mortgagor when the mortgage is on exempt property,[73] such as a homestead, in which case execution could not be taken against the property exempt, but could be sold under mortgage; and, lastly, even if third parties and the mortgagor had no interest in withdrawing the mortgaged premises from liability to be sold under the mortgage, still the Ohio court affirms that "this fact can furnish no authority for changing the legal character and incidents of the mortgage deed."

Exceptions to the Minority Rule.—If the fundamental theory of the minority rule is correct, it would seem somewhat inconsistent to protect the assignee against equities possessed by third parties, yet Illinois[74] and Ohio[75] have both made this exception and have held that an assignee of a mortgage takes free from latent equities. Indeed, this holding is opposed to the weight of authority.[76] If the assignee takes only the interest of his assignor, equities pos-

71. Lamouricuk v. Hewit, 5 Wend. 307.
72. McLaren v. Watson's Executor, 26 Wend. 425.
73. See *McAuliffe v. Reuter,* 166 Ill. 491.
74. *Himrod v. Gilman,* 147 Ill. 293. Compare *Vogle v. Troy,* 232 Ill. 481.
75. *Kernohan v. Manse,* 53 Ohio St. 118.
76. 3 Pomoroy Eq. Jur. sec. 708.

sessed by third parties or by the original parties should be placed upon the same plane.

The courts of Illinois have, in addition, made the following exceptions to the rule, under which it is held that when the mortgagor's equity arises out of a matter collateral to the mortgage,[77] or where the mortgage or deed of trust is given to secure negotiable railroad bonds,[78] or when the mortgage is given to secure accommodation paper,[79] the rule of *Olds v. Cummings* does not apply.

Comparative Analysis of Theories Advanced; Conclusions.— On final analysis, the respective positions of the two lines of authorities are as follows: The majority courts claim that the mortgage is an incident to the debt and therefore partakes of the nature of the primary obligation, the answer being that the mortgage is a *chose in action* and remains such though assigned with a negotiable note. Second, the majority courts make the assertion that the mortgage is enforceable by the assignee free from equities between the mortgagor and mortgagee, because of the original contract itself, an argument to which courts which have adopted the minority rule make no direct reply. Third, to avoid an anomaly, the claim

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77. *Colehour v. State Savings Institution,* 90 Ill. 152, where the mortgagor's equity arose from his right to an indemnity against the mortgagee by the mortgagor's payment of a prior mortgage. The entire transaction arose subsequent to the giving of the mortgage sought to be enforced by the assignee.

To this extent the two lines of decisions, e. g., the majority and the minority rule, are in accord. See *Dutton v. Ives,* 5 Mich. 515. Defense arose from a contract entered into subsequent to the giving of the mortgage whereby the mortgagee contracted with the mortgagor to pay off a prior mortgage in favor of the third party, the court holding that such payment was no defense to the assignee's suit to foreclose.

78. *P. & S. R. R. Co. v. Thompson,* 103 Ill. 187. The exception here seems to spring from motives of public policy. The court says, "The rule in *Olds v. Cummings* rests at least in part on technical grounds, which have lost much of their force in more recent times by reason of the manifest tendency of judicial thought to an equitable standard, and while it is not intended to question the authority of that case, yet for the reasons suggested we do not think the principle should be extended to cases that are not clearly shown to be within the rule therein announced. In the case of an ordinary mortgage or deed of trust to secure a temporary loan from one individual to another the note or evidence of indebtedness taken at the time, although it may be negotiable, is not given for the express purpose of being put upon the market and used as a permanent investment of capital, as in the case of railroad securities. In short, we hold that the doctrine of *Olds v. Cummings* has no application to deeds of trust given to secure railroad coupon bonds intended to be thrown upon the market and circulated as commercial paper."

79. *Buehler v. McCormick,* 169 Ill. 269. The court justifies the exception on the ground that the very purpose for which accommodation paper is given is that it may be assigned, and as it is without consideration, it cannot be enforced by the original parties, and the application of the rule in *Olds v. Cummings* would defeat the security and render it nugatory.

is made by the majority courts that the rights of the assignee should be of as high an order in a court of equity as they are at law, to which the reply is made that there is no anomaly for the rights of third parties may be affected and the mortgagor's rights are clearly affected when the mortgage is on exempt property. Fourth, under the majority rule, the claim is made that the assignee is entitled to protection under the recording acts and a similar claim is likewise asserted under the minority rule. Fifth, in one of the majority cases it is suggested that the minority rule may be justified where the title theory of a mortgage obtains, but not in states where the lien theory prevails, an argument which has not been considered by the minority courts. And last, by majority courts it is urged that the mortgagor should be protected on considerations of public policy, to which no reply has been made in decisions holding to the minority view. The minority courts make one further claim which has not been considered in the opposing decisions, namely, that the mortgagor should be protected because he possesses the older equity.

While recognizing the force of the arguments presented in support of the majority rule, it is submitted that on strict theory, the minority opinion is entitled to more consideration than has been given it by the courts. A mortgage is recognized everywhere as an incident to the debt, and the former will follow the latter wherever it goes, but the fact that the primary obligation has power to draw the security with it does not in itself warrant the further conclusion that the essential attributes of the primary obligation are by virtue thereof imparted to the security. If such is the case, it must be for other reasons. Do they spring from the contract?

There is no doubt but that the mortgagor, by giving his note to the mortgagee, contracts to pay the face of the note to him, and also contracts to pay to any subsequent holder in due course of the note the amount called for by the note, free from all personal defenses which he may have against the payee mortgagee. It is hardly correct to say that the maker contracts to assume this obligation with respect to all holders in due course. There is no privity of contract between them. More accurate is it to say that a promisor who has made a promise in a particular form is under this exceptional obligation with respect to holders in due course of the paper, not by virtue of any contract—because in reality there is no privity of contract between them—but because of an obligation imposed upon the maker by law. This legal obligation is an exception in the law of contracts. It owes its origin to the law merchant and to modern statutes. The question arises, is the mort-

gage, given to secure the two-fold obligation, e. g., the one to the payee and also the one which the law has imposed upon the maker with respect to holders in due course. Does it secure both? If it does, may it be enforced to the same extent—e. g., free from personal defenses—as the original note may be? It would seem that in order to enforce the mortgage to this extent there must be some legal obligation resting upon the mortgagor to pay to the assignee of the mortgage as such the full amount free from personal defenses. On analogy with rules governing negotiable paper, this legal obligation ought to spring only from statutory authority. To raise it by judicial construction of the contract is not free from grave difficulties. In answer, while it may be argued that under the majority rule the mortgage is not made negotiable in the technical sense, the fact still remains that under the rule the mortgage is regarded as possessing some very essential characteristics which only attach to negotiable instruments. To imply these characteristics to a totally different class of obligations, even for the single purpose, is questionable on strict theory. If a strict contract theory would support the doctrine by parity of reasoning other forms of collateral securities to negotiable notes should have imported to them the attributes of negotiability. But this has not been the case.

The fundamental conditions precedent underlying the whole law of negotiable instruments is that the obligation in order to be negotiable must contain an unconditional promise to pay a sum certain in money. But the obligation of a mortgage is essentially conditional. The property mortgaged becomes liable to satisfy the debt to the mortgagee or his assignee only on condition that the mortgagor has defaulted in his primary obligation on the note. It is difficult to see, therefore, how a mortgage can be negotiable or can in any sense be possessed of any of the characteristics of negotiability. Springing from this fundamental principle of negotiable instruments, the generally accepted doctrine certainly is that collateral guaranties to notes, either endorsed on the paper itself or on separate paper, are not deemed negotiable.[80] The same is true with reference to agreements authorizing the sale of collateral. While there is a wide difference between these securities and a mortgage, yet the analogy on this particular point seems sufficiently close to warrant a question as to the reasons why the rights of the assignees of the respective securities should not be determined by

80. 2 Daniel On Negotiable Instruments, p. 805. Of course a guarantor may by express wording of the contract of guaranty bind himself as to all subsequent holders of the note which is guaranteed.

the same rules. On the whole a question of some doubt may well be raised as to whether the principle that a mortgage is incident to the note and the argument arising from a construction of the contract can furnish a foundation upon which to rest the majority rule.

The argument that in as much as the assignee can take execution against the mortgagor's property after judgment on the note, he should, therefore, be allowed to foreclose on the mortgage can scarcely be supported. There is no anomaly in holding that one cause of action may be totally different from another cause of action, even though both arise from the same transaction. As a necessary consequence the respective remedies and their extent may vary greatly.

May the assignee of the note and mortgage be protected as a *bona fide* purchaser? An assignment of a mortgage is usually within the recording acts.[81] But it is not a strict conveyance of a legal title even in those states where the title theory of a mortgage obtains. Under the generally accepted theory of an assignment legal title does not pass.[82] At most, the interest acquired by the assignee is a power of attorney to sue in the assignor's name. The assignee, if a purchaser at all, is a purchaser only of an equitable interest, and the general rule that the doctrine of *bona fide* purchaser for valuable consideration does not apply to transfers of mere equitable interests prevents his protection on this ground. The same doctrine is expressed by the general rule that the holder of a power of attorney only cannot claim protection as a *bona fide* purchaser. The holder of such an interest is not a *bona fide* purchaser. It is difficult to see, therefore, how the assignee can be protected under this theory. On the other hand, in so far as the mortgagor can claim protection under the rule that the record of an assignment cannot operate retrospectively,[83] the contention of the minority courts is undoubtedly sound.

Would the answer be the same if the assignee of the note were also the assignee of the mortgage under a deed executed with all the formalities of a regular conveyance?

The cases examined as a basis for this paper have not, it is admitted, dealt with this aspect of the question, but on a general

81. 2 Pomeroy Eq. Jur. 3 ed., sec. 233, note 1b., citing general rule, but some states *contra.*

82. *Barrett v. Hinckley,* 124 Ill. 22, holds that an assignee cannot maintain ejectment against the mortgagor. An instrument in order to pass legal title must be under seal. While a deed in the form of an assignment with apt words of conveyance may pass the mortgagee's title, this is not usually done.

83. Pomoroy Eq. Jur., Vol. 2, Sec. 733.

principle and from an Illinois decision[84] the position may be ventured that if a case of this nature were presented the assignee might be a *bona fide* purchaser. In support of this position it may be said (speaking of states where the title theory of a mortgage prevails) that a mortgagee does hold the legal title to the mortgaged premises. True it is a defeasible legal title, but until condition broken legal title is in the mortgagee. The mortgagee may divest himself of his interest in three ways: first, by assignment of the note only, in which case the assignee of the note becomes the equitable assignee of the mortgage but not of the legal title to the mortgaged land; second, by assignment of the note and an assignment of the mortgage deed in the ordinary way, in which event the assignee is still in practically the same position as before, e. g., the holder of the beneficial interest in the mortgaged premises but not of the legal title; third—and this method raises the specific point under discussion—may the mortgagee transfer absolutely all of his interest, both legal and equitable, to his assignee? May the mortgagee actually convey as well as assign his interest? If he may, then the rule that the assignee of a mortgage, being but the holder of an equitable interest and hence not entitled to protection under the doctrine of *bona fide* purchaser does not apply because the assignee has more than an equitable interest. If the assignee obtains an actual conveyance of the legal estate from the mortgagee then he should become a *bona fide* purchaser if other requirements are met.

By way of analogy the rule is well recognized that an assignee of a share of stock by exercising his power of attorney and obtaining a transfer on the books of the registrar company becomes the holder of the legal title and a *bona fide* purchaser. In speaking generally of the rights of an assignee of a *chose in action* who has in addition obtained a legal title, Pomoroy states the broad proposition that to such a person "the doctrine of *bona fide* purchaser for valuable consideration may apply so as to protect him against all such outstanding equities."[85]

In the application of this principle to the assignment of mortgages the Supreme Court of Illinois, in the case above referred to,[86] says, "But that the mortgagee * * * might by deed in the form of an assignment pass to the assignee the legal as well as the equitable interest of the mortgagee, we have no doubt, though there is some conflict on this subject." The court continues, "The doctrine

84. *Barrett v. Hinckley,* 124 Ill. 32.
85. 2 Pomoroy Equity Jur. §712.
86. *Barrett v. Hinckley,* 124 Ill. 32.

would seem to be fundamental, that if one *sui juris,* having the legal title to land, intentionally delivers to another a deed therefor containing apt words of conveyance, the title, at law, at least, will pass to the grantee." In the supposed case, therefore, where the assignee of the note has also obtained an assignment of the mortgage deed under apt words of conveyance, no reason is perceived why such an assignee would not be a *bona fide* purchaser. At least in Illinois, some strength is lent to the contention that an assignee of a mortgage, by observing these requirements, may gain priority over the mortgagor and thus be protected against personal defenses possessed by the latter in spite of the rule in *Olds v. Cummings.*[87]

If the mortgagor and assignee are regarded as holders of equities in the mortgaged property, the maxim that of equal equities the oldest in time shall prevail, sometimes cited in support of the minority rule, is deserving of consideration. While there are many exceptions to this very general rule, at the same time the doctrine contained in it furnishes the fundamental basis for the numerous rules governing priorities. Even on the assumption that the two equities are equal, the principle lends some force to the minority rule. However, it may be doubted whether the facts present the ordinary situation calling for the application of this doctrine.

The suggestion made by the Nebraska court,[88] that the minority doctrine is supportable in states where the title theory of a mortgage is in force but not in states where the lien theory obtains, is of doubtful soundness. Certainly it has not been so urged by other courts. Of the three states which recognize the minority rule, two, Ohio and Indiana, are title states, but the remaining one, Minnesota, is a lien theory state. Of the twenty states supporting the majority rule, seven, Kentucky, Massachusetts, Missouri, New Hampshire, New Jersey, North Carolina and Tennessee, are title states, and thirteen, Colorado, Indiana, Iowa, Kansas, Michigan, Nebraska, New York, North Kakota, Oklahoma, South Carolina, South Dakota, Texas and Wisconsin, are lien theory states. Apparently the courts have made no distinction based on the different conceptions of a mortgage. Save Nebraska, no other state has referred to it. In view of the fact that all courts, including England, whether they treat a mortgage as a defeasible conveyance or as creating only an equitable lien, regard a mortgage for purposes of

87. Under this view, apparently there would be no difference between the positions of an assignee of a note before or after maturity or of a non-negotiable bond.

88. *Webb v. Hazelton,* 4 Neb. 308.

assignment as essentially a *chose in action,* the assignee acquiring in all states interests which are practically the same, it is difficult to see how this difference in the nature of a mortgage can affect the rights of the assignee.

The law is filled with illustrations of doctrines supportable only upon the hazy, but nevertheless safe, foundation of public policy. Whether it is applicable to the state of facts under discussion, as suggested by the New York court,[89] is the question. It may be, however, that public policy is of more importance in furnishing a basis for the majority rule than is indicated by the fact that it has been partially relied upon in but a single case. Whether it is good public policy to protect the assignee or the mortgagor may be a matter of opinion upon which courts may logically differ, thus leaving the problem after all to be solved by the application of definite legal principle.

In conclusion, should an instrument, having reasonably definite characteristics, which passes interests in property, which creates rights and obligations peculiarly within the jurisdiction of courts of equity be changed and endowed with new characteristics drawn from the common law simply by virtue of its being a security for a particular form of a common law obligation? Has there been a confusion of common law principles governing negotiable instruments with equitable principles governing priorities among different claimants? In view of its historical development, the conflict of authority and the reasoning suggested, a question may be raised, at least on strict theory, as to the soundness of the majority rule.[90]

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89. *Gould v. Marsh,* 1 N. Y. 566.

90. The conflict of authority has called forth comparatively little discussion on the part of the writers in legal periodicals and text books. For such discussions, see:

29 Chicago Legal News 72, article by Wallace Hickman on "The Rights of an Innocent Holder for Value of Commercial Paper Secured by a Mortgage or Trust Deed on Real Estate in Illinois," containing a criticism of the doctrine of *Olds v. Cummings.*

37 Albany Law Journal 44, article by Henry T. Terry, on "Mortgages as Choses in Action," in which a question is raised as to whether a mortgage is, in reality, a chose in action.

2 Central Law Journal 500, article on "Negotiable Character of Mortgages," being a criticism of the majority doctrine in which the writer takes the view that "a mortgage is precisely the same instrument, whether it be made to secure a note negotiable or non-negotiable, or no note at all, the authorities recognize it as having a character of its own. Two separate interests are created, one a personal liability, and the other an interest in land. A mortgage is simply an instrument conveying an interest in land. The character of this interest does not depend upon the nature of the obligation it is intended to secure."

Professor Pomoroy in his Equity Jurisdiction, Vol. II, Sec. 704, note 1, C, takes a somewhat similar view and criticises the majority rule in the

following language: "The reasoning of these Illinois decisions is, in my opinion, most in accordance with the settled doctrines of equity jurisprudence, namely, that the assignment of the mortgage, whether it be an incident of the transfer of the note or be direct, is wholly equitable and gives only an equitable title to the assignee and must therefore be subject to all equities; the doctrine of *bona fide* purchaser for valuable consideration not applying to transfers of mere equitable interests."

See also:

23 Am. L. Reg. (N. S.) 201. "Assignments when not subject to equities."

15 W. L. Bul. 3, article by William M. Rocke on "Negotiable Notes Secured by Mortgage."